Are U.S. International Transactions Statistics Adequate?

If one views "adequate" according to either of two rather extreme definitions of the term, U.S. international transactions statistics conform to neither and can be characterized as being in a less dramatic position -- somewhere in between "no more than barely sufficient" and "fully sufficient for a specified or implied requirement." In fact, the international (and national) statistics of most leading nations are in the same boat -- certainly with room for improvement but of reasonably high quality and "adequate" for most analytical and policy purposes.

THE STATISTICAL DISCREPANCY

The emergence of very large statistical discrepancies (errors and omissions) in the U.S. international accounts in the past few years, particularly the positive (inflow of) $41.4 billion in 1982, has generated an increasing number of comments concerning both the adequacy of the accounts and the allocation of the discrepancy between the current account (goods, services -- including investment income -- and unilateral transfers) and the capital account (bank-reported flows, direct and portfolio investment, etc.). It should be stated that a large discrepancy per se does not indicate that the accounts are worse than if there were a small, or even zero, discrepancy. The discrepancy is a net figure, resulting from errors and/or omissions on the credits and/or debits side of the accounts (conceptually, recorded credits and debits should be equal and offsetting, but in practice almost never are in any specific time period, due to differences in timing and recording methods and/or recording gaps.) Even under a strict exchange control system, a discrepancy could arise.

Given the expansion of international transactions in an increasingly interdependent world, it would be surprising if there were not some increase in the discrepancy, although the size of the U.S. discrepancy in recent years remains troublesome. Parallel with the growing discrepancy in the overall U.S. international accounts has been a growing statistical asymmetry in global current account statistics. This development suggests, as the International Monetary Fund (IMF) has noted, that "at least part of the discrepancy may be in the current account." Some private sector observers have been much less guarded in their comments, attributing as much as one-half (or $20 billion) of the 1982 U.S. discrepancy to the current account, emphasizing a probable underreporting of services exports and of investment income receipts, and relating that to the world current account discrepancy. The Bank for International Settlements (BIS), in contrast, has commented that the large U.S. discrepancy, in the main, "probably consists of unidentified capital inflows", largely attributable to interest rate differentials, concerns about the international debt crisis and the international banking system, and the strength of the dollar (actual and expected).

A technical point to be noted is that the discrepancy in the U.S. international accounts (involving an unknown mix of errors and omissions in both our current account and capital account statistics) is, despite some similarities and possible overlaps, not directly relatable to the world current account asymmetry or discrepancy (representing a residual difference between total world payments and receipts on current account only, ignoring all capital flows).

In any event, specific allocations of the discrepancy to particular sectors of the international accounts can be misguided and inappropriate. There is no reason to presume that the net effect of improved reporting in the current account sector would be to increase receipts, rather than increase payments. In fact, there might be a better case to be made for exactly the opposite conclusion (see discussion of service accounts in the next section). Given the political, economic and financial, and military uncertainties in many areas, in contrast to the relative stability in and favorable prospects for the United States, there is reason to agree with the BIS that most of the U.S. discrepancy is accounted for by unreported capital inflows. Also supporting this view is the extreme quarter-by-quarter volatility of the discrepancy (swinging, during 1980 for example, from a $67 billion annual-rate inflow in Q2 to a small annual-rate outflow of $56 million in Q4) combined with an apparent correlation of some of its widest swings with developments such as exchange-market expectations of a weaker or stronger dollar; tightening or loosening of U.S. monetary policy, including early-1980 domestic credit-controls; and a possible differential confidence effect of the initial LDC debt crisis, in Q3 last year, on Euro-dollar versus U.S. banks (see chart).

An analysis by the IMF of the large global current account asymmetry "provides some reassurance that the main outlines of the global payments pattern would remain essentially similar if the asymmetry could be eliminated." The same degree of reassurance would seem to be in order for the United States current account. Nonetheless, any meaningful analysis of overall U.S. international transactions should include unrecorded flows -- the discrepancy -- as well as recorded flows.

THE CURRENT STATUS OF THE U.S. INTERNATIONAL ACCOUNTS

The following is a brief review of selected components of the U.S. international accounts, their relative reliability and current and prospective efforts to improve them. Within the current account, the merchandise trade statistics are in reasonably good shape, with no evidence of recent deterioration. The Census Bureau's basic data, and BEA adjustments to them for balance of payments purposes, often exhibit unusual monthly volatility, but this is not a quarterly or an annual problem. Efforts to improve monitoring of merchandise trade transactions should continue, to reduce possible undercounting of U.S. trade flows, particularly exports.

Among the service accounts, the estimates for a number of components need improvement. This is largely a reflection of reporting gaps in BEA surveys and the voluntary nature of some of these surveys (as opposed to mandatory reporting in many of the other accounts). To narrow reporting gaps, BEA has expanded the survey of foreign contract operations of U.S. companies to collect more data; has increased the number of questions pertaining to services and the number of separate service industries in the 1982 survey of U.S. direct investment abroad; has cooperated with the U.S. Travel and Tourism Administration in the institution of new surveys of foreign travelers in the United States and U.S. residents traveling abroad, so as to increase response rates; and, if resources are available, will collect additional information on trade in services, including a new annual survey of foreign contract operations in the United States, and a new annual survey of U.S. direct investment abroad (with an emphasis on services). Reporting to BEA on military items in the services accounts is improved, compared with earlier years, due to close monitoring and improved cooperation with the appropriate Defense agencies. The transportation accounts were revised for 1980-1982, reflecting improvements in methodology; the results were published in the June 1983 Survey of Current Business (with the net effect of increasing payments). Close cooperation with most large reporting corporations has continued to produce reliable estimates for the direct investment income accounts.

Estimates for receipts and payments of income on portfolio investment have benefited from recurrent discussions with and visits to money market center banks concerning appropriate yields, fees, spreads, etc., to be applied to reported principal amounts of various types of loans to and borrowings from foreign branches, banks, and non-bank foreigners. Revisions to methodology have been instituted several times in recent years as a result of such discussions, which have served to keep the estimates more attuned to market practices. The net effect has been to <u>reduce</u> net receipts substantially. (In addition, to whatever extent past cumulative errors and omissions inflows may have been accounted for by unreported portfolio capital inflows, subsequent accruals of investment income payments on these financial liabilities have been missing from our estimates, resulting in a corresponding <u>overstatement</u> of net portfolio income.) In sum, the above factors tend to support the proposition that reporting gaps in the services accounts could just as well result in a net understatement of <u>payments</u> as of <u>receipts</u>. Indeed, revisions in recent years, reflecting new information and improved methodology, have reduced receipts, or increased payments, by substantial amounts in transportation and in investment income.

Although regional and bilateral allocations of overall international transactions statistics are subject to important reservations, there are indications of rather wide discrepancies between U.S. and Japanese data. Thus, it might be worthwhile, if resources could be committed and if the Japanese would agree, to plan and initiate a bilateral current account reconciliation with Japan. Preliminary U.S. Customs efforts toward a merchandise trade reconciliation with Japan are being explored. The successful U.S.-Canadian current account reconciliations of recent years would serve as the model, although the unique degree of cooperation between the United States and Canada is not likely to be duplicated, and there are rather wide differences, including language, conceptual framework and accounting practices, between Japan and the United States.

It is in the <u>private capital accounts</u> that most of the unrecorded inflows of foreign funds probably are concentrated. To the extent that there is a strong desire on the part of some foreign investors, for whatever reasons, <u>not</u> to reveal the identity of the ultimate investor, there is not much that can be done to change the situation. As a result, there probably are substantial slices, particularly of foreign portfolio investments and, to a lesser extent, foreign real estate investments, that are mistakenly regarded by U.S. reporting institutions as domestic (U.S.) investment. Among the gaps in capital flow statistics, other than this "masking" problem, the most important is probably associated with portfolio investment inflows. Although reports are clearly required by existing regulations on any transactions which would change reporters' claims on or liabilities to any foreign entity, reports to Treasury on such flows, particularly by nonfinancial corporations, and to a lesser extent by banks, may be plagued by uncertainties as to whether the reporting requirements apply to some transactions, including new financial market practices and instruments. As for direct investment estimates, although both surveys and data underlying the estimates have improved markedly in recent years, and, in particular, more resources have been allocated to the increasingly important flows associated with foreign direct investment in the United States, such data probably are still subject to reporting gaps, especially those involving complex legal structures and/or forms of management and ownership.

<u>SUMMARY AND CONCLUSIONS</u>

In sum, U.S. international transactions statistics can be characterized as adequate, but certainly with room for significant improvement. The emergence of a very large statistical discrepancy is uncomfortable, to say the least, but should not be viewed as an indicator of unreliability of the statistics. Rather, it is, to a great extent, an indicator of global economic, financial, socio-political and military instability, and of the relatively stable conditions and more promising outlook for the United States than many other leading areas.

Although needed efforts to improve U.S. statistics are underway, it should not be expected that such efforts will lead to a disappearance of significant diminution of the statistical discrepancy in short order. Improvements should be expected to result in better estimates for the appropriate accounts, whatever the discrepancy might be. Hopefully -- and there are indications thus far in 1983, particularly in the second quarter, that this indeed may be the case -- the record 1982 discrepancy will not be repeated in 1983. But the discrepancy may remain rather large until there are improved prospects for a more stable and prosperous world economy.

Statistical Discrepancy in U.S. Balance of Payments

(Quarterly data, not seasonally adjusted)